
I'm HIPP, and That's Not Cool

By John Rafferty *Wed, Sep 22, 2021*

Our guest columnist, an experienced annuity marketing executive, just founded Rafferty Annuity Framing LLC. He points out that the annuities with living benefits still provide longevity risk protection at a reasonable price for affluent Boomers.



Huey Lewis and The News once sang, "It's Hip to be Square." My wife and I are also HIPP. We're "High Income, Pre-retired, and Pension-less." HIPP is not so cool. I don't think it squares with a solid retirement strategy.

We are almost debt-free, but we are also at least five years from retirement. We hope the market will feather our retirement nest in the interim. There are millions like us: folks nearing retirement who have saved considerable sums, who are accustomed to a healthy annual income from our work, and who expect no sources of guaranteed lifetime income other than Social Security at retirement.

Markets have delivered for a long time. It's easy to assume they'll deliver that desired nest egg when you need it. But markets deliver until they don't. Then you need a back-up plan. That's where annuities can step in and become the heart of a retirement strategy.

A Real CAPE to Fear

We've been conditioned, if not spoiled, by a decade of sparkling capital markets performance. But historically low Treasury yields, tight spreads and high equity valuations do not bode well for future performance.

One valuation metric to watch is the Shiller CAPE, or Shiller Cyclically Adjusted Price Earnings Ratio, or CAPE. Developed by Yale economist Robert Shiller, the CAPE smooths out the lumpiness of price/earnings ratios that short-term, transitory events can cause. It averages the inflation-adjusted earnings of a firm or an index over the prior ten years and compares those earnings to the current price.

The last time the Shiller CAPE was as high as it is today (around 38) was in 1999, according to one recent article. Between 1999 and 2003, the S&P 500 Index (including dividends) lost money. It had a compound annualized growth rate of about -0.62%. Although fixed income

performed better during that period, today's low yields suggest that bond returns will be muted in the future.

Helping clients to the finish line

The annuity industry fortunately offers a way to convert some of the capital market's recent bounty into lifetime cash flows that conventional capital methods will find tough to match. The guaranteed lifetime withdrawal benefit (GLWB) offers an excellent hedge to the prospect of below-average market returns in the critical years before and during early retirement.

Assume that a 60-something couple wants to retire in five years. Any number of fixed indexed annuities (FIA) with a GLWB **purchased** today, can produce an annual cash flow equal to 6-7% or more of premium amount or the contract value (whichever is greater) five years from now.

For example, if a 62-year-old couple funds an annuity with a lifetime withdrawal benefit with a \$1 million premium, they could expect a lifetime cash flow of at least \$65,000 a year, covering both lives, beginning in five years. Variable annuities with high joint distribution rates are **rarer**, but the 6.5% (of initial premium) rate can be reached with a five-year delay to age 70.

To enjoy the same income using a simple 4% annual withdrawal rate, the couple would need their \$1 million to grow to \$1.625 million in five years—a return of 10.2% per year (net of fees). If the couple would like to use a more conservative 3% withdrawal rate—as experts like David Blanchett, Wade Pfau, and Michael Finke have suggested—the annual returns needed to equal the annuity results would be about 16.7%.

The annuity can be especially helpful for people who have under-saved for retirement. Suppose our 62-year-old couple realizes that, to close the gap between their Social Security benefits and their essential expenses in retirement, they will need to spend a risky 6% or 7% of their savings every year. The GLWB will give them the income they need without the substantial risk of exhausting their savings too soon.

But even for HIPP folks with seven-figure portfolios, a 3% to 4% withdrawal rate might not provide enough safe monthly cash flow to replace pre-retirement income and maintain an accustomed lifestyle.

Caveats are in order. Most safe withdrawal rate methods include inflation-adjustments; they

typically allow annual withdrawals to grow by 2% to 3% of the initial amount. The GLWB solutions I recommend may offer a version that allows for growth, but those solutions would start at lower payouts than the versions I've referenced.

But an annuity with a GLWB can maximize cash flow potential at minimum risk during the initial travel-intensive, "go-go" years of retirement. That makes it an excellent lifestyle hedge. Owning that type of annuity might even make it cool to be HIPP.

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